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THE UNIFORM PARTNERSHIP ACT

It is now twenty-five years since the organization of the body known as the Conference of Commissioners on Uniform State Laws. Their main work has been, and still is, to express in legislative form, clarify, simplify and make uniform our commercial law, using that term in its broadest sense. They have drafted and recommended to the legislatures of the States, the Negotiable Instruments Act, the Warehouse Receipts Acts, the Bills of Lading Act, the Transfer of Stock Act, the Sales Act, and the Partnership Act. The Negotiable Instruments Act was adopted by the Conference in 1896. It has now been passed by forty-seven state legislatures. The Bills of Lading Act was adopted by the Conference in 1909. The last commercial act adopted prior to the adoption of the Partnership Act last October, was passed by eleven state legislatures prior to the present winter. The number of states adopting the other commercial acts vary usually, though not always, with the time which has elapsed since they were first recommended by the Conference. With intelligent coöperation from members of the Bar and commercial bodies interested, it would seem to be merely a question of time when all the states will have adopted this legislation.

This work on commercial law has not been the only work undertaken by the Conference. They have also drafted and recommended an Act Relating to Wills Executed Without the State, a Family Desertion Act, a Marriage Evasion and Violation Act, a Divorce Act, a Marriage and License Act, a Cold Storage of Food Act, an Acknowledgment of Instruments Act, and a Workmen's Compensation Act, besides considering and recommending the Child Labor Act prepared by the National Child

Labor Association, and the Pure Food Act modeled after the United States Pure Food and Drugs Act. But various local and economic conditions, and the conflict of opposing social forces have so far made it impossible to secure the general adoption of these non-commercial acts. While such an act as the Act Relating to Wills Executed Without the State has been adopted in nine states, the Divorce Act which passed the Conference in 1906 has only been adopted by three state legislatures.

It may fairly be said, therefore, that the work of the Commissioners, outside the field of commercial law, while of great value, is primarily suggestive and educational. For instance, no reasonably informed person desirous of improving the child labor laws of his state would draft an act on that subject without examining the Uniform Child Labor Act recommended by the Commissioners; and such a person would undoubtedly incorporate many of the features of the Uniform Act into his own bill, but he would probably also find that local conditions rendered it advisable to make more or less drastic many of the provisions.

Even were it practically possible to secure the general adoption of the Uniform Child Labor Act or the Uniform Workmen's Compensation Act the acts would probably be changed in many respects within a few years. Legislative problems growing out of child employment in industry and industrial accidents are primarily administrative. In both fields of regulation there is yet much to be learned from practical experience. An act dealing with either subject which is practically possible today may be quite different from an act on the same subject practically possible two or three decades hence.

On the other hand, in expressing in legislative form our commercial and business association law, the Commissioners, if their work is well done, are creating that which will probably long outlast the present generation. The Uniform Negotiable Instruments Act, for instance, which was the first act sanctioned by the Conference, would have been equally applicable to commercial conditions in the early eighteenth century, and, with comparatively slight modifications, could have been adapted to conditions in classic Rome. Again, in spite of recent great industrial changes, the Uniform Partnership Act would have met conditions in Lord Mansfield's day as well as those of today. As these two acts would have worked as well in 1765 as in 1915, there may be a reasonable expectation that they will meet conditions of one hundred and fifty years hence, and what is true of these two acts is true of the other commercial acts drafted by the Conference.

This work of expressing in legislative form our commercial law will be comparatively permanent only if it is well done. To have it well done takes time and intelligent effort. Intelligent effort, when translated by the practical experience of the Commissioners, means patient, intelligent, group criticism of expert suggestion. When the Commissioners—or, as the body is technically called, “The Conference of Commissioners”—decide to draft a law on a commercial subject they authorize their standing Committee on Commercial Law to submit a draft; they also now invariably authorize their Committee to employ a draftsman. The initial work is done by the person so employed.

My personal experience leads me to believe that the draftsman should not work alone. The draft which he submits to the Committee should have had its every sentence wrangled over by one or more good men. For this, those of us who are connected with Law Schools have an advantage. We can use our graduate students or the holders of graduate research fellowships as persons on whom to try out our ideas. The holder of a graduate fellowship in law is almost invariably a man of real ability. If his nature is a fighting one, so that he will come back in argument, he will render the draftsman invaluable service. In this way I am under a very real obligation to Mr. James B. Lichtenberger, now in the active practice of the law in Philadelphia, who, as one of the Gowen Memorial Research Fellows in the Law School of the University of Pennsylvania, devoted more than a year to the study of partnership in connection with the first two drafts for which I was responsible.

The draftsman has a heavy responsibility, but his responsibility is to the Committee on Commercial Law. The Committee, not the draftsman, is responsible to the Conference. I am in a position to testify that this responsibility is taken seriously. The first group criticism to which the draft is submitted is that of the Committee. The members of the Committee spend much time over a draft before submitting it to the Conference. They also send copies of the proposed draft for criticism to selected lists of persons who are believed to have some special knowledge of the subject of the proposed act inviting suggestion and criticism, besides frequently calling into conference with them those who from their peculiar opportunity may be supposed to have an expert knowledge of the subject. Thus in connection with their work on the Partnership Act, before the Committee determined to adopt the legal theory of the nature of a partnership on which the Act is drawn, they called into a conference, which lasted two

full days, all the teachers of partnership in the larger universities of the United States and a number of lawyers of eminence known to have had large practical experience in partnership business.

The personnel of the Committee on Commercial Law is also worthy of note. During the years when the Partnership Act was in course of preparation its membership included Mr. Mordecai of South Carolina, a leading lawyer of that state with a very large partnership business, and Professor Samuel Williston of Harvard, the draftsman of all the other commercial acts except the Negotiable Instruments Act; while the most prominent writer on partnership, Professor Francis M. Burdick of Columbia, though not at that time a member of the Committee, attended every session at which the Partnership Act was discussed, giving invaluable assistance.

But no matter how carefully the first draft may be prepared, experience has shown both the Conference and its Committee that the first draft should not be submitted to the Conference for adoption, but merely for criticism and instruction as to the nature of the changes which it is desirable to insert in the second draft. The object is not primarily to get the work done, but to get it well done. An act on a commercial subject needs much more group criticism than it is possible for the Conference to give at any one annual session. Time also must be given for the wide distribution of the draft and a consideration of the suggestions and criticisms received. With the exception of the Negotiable Instruments Act, none of the commercial acts have been adopted by the Conference in less than three years from the time the first draft has been submitted, while on many of the acts the Conference has spent considerably longer time.

To this record of careful work the Partnership Act is no exception. It is more than twelve years since the Conference instructed its Committee on Commercial Law to draft and submit such an act to "The next Annual Conference." Since then, and prior to the final adoption of the Act on October 14th last, no less than eight tentative drafts were before the Commissioners, and discussion of the final drafts has occupied a large part of their annual sessions for the past three years.

The first expert employed by the Committee was the late Dean Ames of the Harvard Law School. Mr. Ames submitted to the Committee two drafts. On his death I was asked to take up the work.

The merit of the proposed Act depends upon: First: Whether it states the law in simple, clear language; Second: The extent to which it renders certain existing uncertainties; Third: Whether the changes which it introduces into the law are beneficial.

Those who read the text can judge for themselves whether the Act fulfils the first test. As originally drafted, where it was desired to express in a section the same idea as that expressed in the corresponding section of the English Partnership Act, and the wording of the English Act was clear, its wording was followed without regard to terseness or simplicity of expression. In the preparation of the final draft, however, the Committee, following the express directions of the Conference, reduced the language in these sections to as simple a form as possible. In this work of verbal simplification most valuable assistance was received by the Committee and its draftsman from Mr. Charles E. Shepard, one of the Commissioners from the State of Washington. Thus paragraph 4 of Section 7, giving rules for determining whether a person who shares in the profits is or is not a partner, a paragraph occupying more than a page in the English Act, is in the Uniform Act reduced to twelve lines.

The second test is the extent to which existing uncertainties in the law of partnership are rendered certain. Before answering this question it is perhaps well to emphasize the fact that there is one matter connected with partnership which legislation cannot make certain. By no human ingenuity would a Partnership Act which does not abolish common law partnerships enable the person who reads it to tell in every supposable case whether there is or is not a partnership.

In the proposed act, Section 6 defining a partnership reads:

“(1) A partnership is an association of two or more persons to carry on as co-owners a business for profit.

“(2) But any association formed under any other statute of this state, or any statute adopted by authority, other than the authority of this state, is not a partnership under this act, unless such association would have been a partnership in this state prior to the adoption of this act; but this act shall apply to limited partnerships except in so far as the statutes relating to such partnerships are inconsistent herewith.”

The next Section follows the English act in giving rules to assist in determining whether a partnership does or does not exist. Thus paragraph 4 of the Section provides that the receipt

by a person of a share of the profits of the business is *prima facie* evidence that he is a partner in the business, but no such inference shall be drawn if such profits were received in a payment of a debt, as wages, as rent, as an annuity to a widow or representative of a deceased partner, or as interest on a loan though the amount of profits vary with the profits of the business. This and the other rules given express the net result of the decisions on what constitutes a partnership, from the famous early case of *Waugh v. Carver*¹ before Lord Chief Justice Eyre to the present day.

In spite of these rules, however, it will always be possible to give a number of real or supposititious cases in which men will differ as to whether the facts show co-ownership of a given business. The uncertainty lies in the fundamental characteristic which distinguishes partnerships from every other business association. All other business associations are statutory in origin. They are formed by the happening of an event designated in a statute as necessary to their formation. In corporations this act may be the issuing of a charter by the proper officer of the state; in limited partnerships, the filing by the associates of a specified document in a public office. On the other hand, an infinite number of combinations of circumstances may result in co-ownership of a business. Partnership is the residuum, including all forms of co-ownership, of a business except those business associations organized under a specific statute.

If a partnership act were to declare that a partnership was not formed until the formal requirements of the statute were complied with, it would not be a statute regulating common law partnerships, but one abolishing common law partnership and establishing a new form of statutory association. If no formal act can be specifically designated as a necessary prerequisite to the formation of a common law partnership, it follows that it is not always easy to determine whether the acts proved indicate co-ownership of a business. Ownership, whether the ownership of a business or the separate ownership of personal or real property, involves the idea of control; but the degree of control necessary is incapable of exact definition. Neither is it possible to catalogue all the possible combinations of fact, which, when found to exist, will conclusively prove ownership.

¹2. H. Bl. 235 (Eng. 1793).

For example: take the leading case of *Cox v. Hickman*². There a firm engaged in the iron business failed. The creditors made an arrangement with the members of the firm and certain so-called trustees, by which the legal title to the property was vested in the trustees, who conducted the business under the possible if not the actual direction of the creditors. Out of the receipts, after paying the operating expenses, they were to pay the creditors. When the creditors had been paid in full, the property was to be returned to the original owners. The question at issue was whether the creditors of the original firm had created a new partnership of which they were members. The English judges decided that no such partnership was created. The proposition for which the case stands, however, must be confined almost to its exact facts. Change these facts slightly and there will be a doubtful case, and one which will remain doubtful after the adoption of the Uniform Partnership Act or any other conceivable act.

If, however, it is not possible for any statutory statement of the law to do away with those uncertainties which may arise under supposable combinations of fact as to whether a particular association is a co-ownership of a business, many other uncertainties in our partnership law and its administration can and will be done away with by the adoption of the Uniform Act.

The uncertainties of our common law in this country are due, in great part at least, to three distinct causes: Conflicts between the decisions of the different states, absence of legal authority, and confusion in legal theory. In our partnership law the first, while a distinct source of uncertainty, is not nearly as potent as the extraordinary lack of authority in any given state, and often in all states, on matters of considerable practical importance. The chief source of uncertainty, however, as well as the source of several distinctly inequitable rules of our existing law of partnership is the confusion in regard to the nature of a partnership and the legal incidents attached to the partner's right in partnership property.

Before taking up the way in which the Uniform Act deals with this major source of defects in our existing law of partnership, a brief reference will be made to some things of minor importance which will be accomplished by the adoption of the Act.

In view of the confusions which have arisen in our law in

² 8. H. L. C. 268 (Eng. 1860).

regard to notice, it is interesting to know that Section 3 of the Act carefully defines knowledge and notice. As there defined, a person has knowledge of a fact, not only when he actually knows of it, but also when he has knowledge of such other facts as should have prompted an investigation; while a person has notice of a fact when the person who claims the benefit of the notice states the fact to such person, or delivers through the mail or by other means of communication a written statement of the fact to such person, or to a proper person at his place of business or residence. It will be noticed that these provisions draw a clear line between knowledge and notice. The fact that the word "notice" in judicial opinions and in other legal writings is often used when "knowledge" is intended has led to a great deal of confusion, of which the extraordinary expression "constructive notice" is evidence. To avoid this confusion, the word "notice," as used in the Act, means that if certain definite things have been done, the person who has done them has a right to assert that notice has been had and to act accordingly, irrespective of whether the person charged has actual knowledge or not.

Lawyers are familiar with existing confusions surrounding the subject of conveyance of real property to or by a partnership. Section 8 permits the acquisition of real property by the partnership in the partnership name, the partnership acquiring the entire estate of the grantor, although the conveyance is without words of inheritance, unless a contrary intent appears. Section 10 deals with the conveyance of real property by a partnership, the section as a whole being a complete codification of the subject. In permitting a partnership to acquire real property by a conveyance executed in the partnership name, the intent of the Conference was to avoid those complications now arising when an attempt is made to make such a conveyance. They also believed that this method of holding real property, not merely when the partnership is formed for trading in land, but in many other cases, would be a real convenience. Of course, it is not probable that the practice of holding title to partnership real estate in the partnership name will become universal. Under the provisions of the Act, where title to real property is in the partnership name, any partner may convey title to such property by a conveyance executed in the partnership name. This gives to each partner a very large control over the property, even though the Act does provide that the partnership may recover the property so conveyed by a partner unless the act of selling is one for carrying on the

business of the partnership in the usual way, or unless the property has been conveyed by the grantee, or a person claiming through such grantee, to a holder for value without knowledge that the partner making the conveyance has exceeded his authority. Still we may expect that a controlling consideration which will move many to place title to real property in the partnership name will be the convenience of being able to convey a good title in case of the death of a partner without having to secure the signature of persons not members of the partnership.

Section 16 which deals with the holding out of persons as partners who are not actually partners, or, as it is usually called, partnership by estoppel, clears several doubts and confusions of our existing case law. It has been held that a person is liable if he has been held out as a partner and knows that he is being held out, unless he prevents such holding out, even if to do so he has to take affirmative action.³ On the other hand, the weight of authority is to the effect that to be held as a partner he must consent to the holding out and that consent is a matter of fact to be proved as any other fact. That Act as drafted follows the weight of authority which is based on better reasoning.⁴

Another confusion connected with this subject of partnership by estoppel arises when A is held out with his consent as a partner of B, B in fact being in business by himself. Can anyone who relies on the representation have priority on the property in the business over those creditors of B who trusted only B and not A and B? The case of *Thayer v. Humphreys*⁵ answers this question in the affirmative. Other cases have reached an opposite conclusion.⁶ The Act in effect takes the position that if there is no partnership in fact the law should not treat any part of B's property as a partnership fund. Under the Act, therefore, in the case put, A and B would be liable jointly, but the creditor who thought there was a firm of A and B would have no priority over the other creditors of B on any part of B's assets.

Section 21 does away with the present confusion which in most states surrounds the obligation of a partner to account for

³ *Fletcher v. Pullen*, 70 Md. 205 (1889); *Rittenhouse v. Leigh*, 57 Miss. 697 (1880); *Speer v. Bishop*, 24 Oh. St. 598 (1874); Prof. Burdick in 30 Cyc. 393.

⁴ *Morgan v. Farrel*, 58 Conn. 413 (1890); *Bishop v. Georgeson*, 60 Ill. 484 (1871); *Ihmsen v. Lathrop*, 104 Pa. 365 (1883); Wood's Collyer, 75, n.

⁵ 91 Wis. 276 (1895).

⁶ Burdick, Partnership, p. 16 *et seq.*

profits derived by him without consent of the other partners from any transaction connected with the conduct of the partnership, or the use of its property. At present it is not always clear whether the obligation to account, when the partner has money or other property in his hands, is or is not an obligation in the nature of a trust. For instance, A, B and C are partners. A, as a result of a transaction connected with the conduct of the partnership, has a specific sum of money or other property which can be traced. A is insolvent. In many jurisdictions it is not certain today whether the claim of the partnership against A is the claim of an ordinary creditor or whether it is a claim to the specific property or money in his hands. The words of Section 21 remove this doubt. They declare that the partner shall "hold as a trustee" for the partnership any profits derived by him from any transaction connected with the partnership business.

Section 27 deals with the assignment of a partner's interest in the partnership. In actual practice, such assignments are usually by way of mortgage in return for a loan not to the firm but to the partner making the mortgage. The partner making such a mortgage does not, except in rare instances, intend to disassociate himself from the business; yet the weight of authority is unquestionably to the effect that all assignments of a partner's interest, whether outright or by way of mortgage, dissolve the firm.⁷ The Section referred to, which follows in this respect the English Act, provides that any conveyance, whether absolute or by way of mortgage, does not of itself dissolve the partnership, nor as against the other partners in the absence of agreement, entitle the assignee during the continuance of a partnership to interfere with the management or administration of the partnership business or affairs, or to require any information on account of partnership transaction, or in respect to the partnership books. Of itself it merely entitles the assignee to receive in accordance with his contract the profits to which the assigning partner would be otherwise entitled. If the assigning partner neglects his personal relation, the other partners may dissolve the partnership under Section 31 of the Act. But the mere fact of assignment, without more, will not have this effect.

The subject of the dissolution and winding up of a partnership is involved in considerable confusion principally because of the

⁷ Bates, §§ 158-168, 931-933; Collyer, 151, 161; George, 153; Kent, 59; Lindley, 397, *et seq.*, 620; Beale's Parsons, §§ 106, 305, 306; Jas. Parsons, § 175; Story, §§ 272, 377, 308.

various ways in which the word "dissolution" is employed. The term sometimes designates the completion of the winding up of partnership affairs. This, the end of the association, should be called the termination of the partnership. Again the term is sometimes used to designate the process of liquidation or winding up. We are frequently informed in the syllabi of cases and in digests that a partnership is not dissolved by the retirement of a member if the other members have a right to continue the business. What is meant, of course, is that the right of winding up the affairs of the partnership does not always exist when the business ceases to be carried on by all the persons who were carrying it on prior to the retirement of one of them. Lastly, the term is employed as designating a change in the relation of the partners caused by any partner ceasing to be associated in the carrying on of the business. As thus used "dissolution" does not terminate the partnership, it merely ends the carrying on of the business in that partnership. The partnership continues until the winding up of partnership affairs is completed. This last is the sense in which the term "dissolution" is used in the Act. Section 29 reads: "The dissolution of a partnership is the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business." Section 30 says: "On dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed."

Section 31 (2) declares that dissolution of a partnership is caused "in contravention of the agreement between the partners, where the circumstances do not permit a dissolution under any other provision of this section, by the express will of any partner at any time." This paragraph settles a matter on which at present considerable confusion and uncertainty exists. It allows a partner to dissolve a partnership in contravention of the agreement between the partners. The word "dissolve" is used in the sense just explained, and is supported by the weight of authority.⁸

⁸ Cal. Civ. Code, § 2417; Ga. Civ. Code, § 2633; Mont. Civ. Code, § 3262; N. Dak. Civ. Code, § 5848; Okla. Civ. Code, § 4850; S. Dak. Civ. Code, § 1736; *Moore v. Price*, 116 Ala. 247 (1896); *Lapenta v. Lettieri*, 72 Conn. 377 (1899); *Clements v. Norris*, 8 Ch. D. 129, 133 (Eng. 1878); *Monroe v. Conner*, 15 Me. 178 (1838); *Cape Sable Case*, 3 Bland. 606, 674 (Md. 1840); *Solomon v. Kirkwood*, 55 Mich. 256 (1884); *Carr v. Hertz*, 54 N. J. Eq. 127 (1895); *Skinner v. Dayton*, 19 Johns. 513, 537 (N. Y. 1822); *Mason v. Connell*, 1 Whart. 381, 388 (Pa.

The relation of partners is one of agency. The agency is such a personal one that equity cannot enforce it even where the agreement provides that the partnership shall continue for a definite time. The power of any partner to terminate the relation, even though in doing so he breaks a contract, should, it is submitted, be recognized. The rights of the parties upon a dissolution in contravention of the agreement are safeguarded by Section 38 (2). Under that Section, where a dissolution is caused in contravention of the partnership agreement, each partner as against a partner who has caused the dissolution wrongfully has a right to damages for breach of agreement. The partners who have not caused the dissolution wrongfully have also the right to continue the business in the same name, either by themselves or jointly with others, during the agreed term for the partnership and "for that purpose may possess the partnership property, provided they secure the payment by bond approved by the court, or pay to any partner who has caused the dissolution wrongfully, the value of his interest in the partnership at the dissolution, less any damages" (caused by the dissolution) . . . "and in like manner indemnify him against all present or future partnership liabilities."

Section 35 provides that which a partner must do on dissolution to be certain that his co-partners may not, by carrying on the business in the partnership name, against his consent, make him liable for future contracts. The Act provides that a partner cannot, after dissolution, bind the partnership to third persons by any act which is not necessary to wind up the partnership affairs or complete transactions then unfinished, unless such third person, not having had relations with the partnership by which a credit was extended to the partnership, has no knowledge or notice of the dissolution, and the fact of dissolution has not been published in a newspaper of general circulation of the place (or of each place if more than one) at which the partnership business was regularly carried on, or unless such third person having had relations with the partnership by which a credit was extended,

1836); *Slemmer's Appeal*, 58 Pa. 168, 176 (1868); *Karrick v. Hannaman*, 168 U. S. 328, 334 (1897).

The English law is opposed to this view: *Peacock v. Peacock*, 16 Ves. 49 (1809); *Featherstonhaugh v. Fenwick*, 17 Ves. 298 (1810); *Crawshaw v. Maule*, 1 Swanst. 509 (1818); *Ferrero v. Buhlmeyer*, 34 How. Pr. 33 (N. Y. 1867); *Lindley* 601; *Storey*, § 275.

upon the faith of the partnership, has no knowledge or notice of the dissolution. Under existing law it is doubtful in practically all jurisdictions whether the third persons who should receive notice are all those who have had business relations with the partnership, or only those who have had relations with the partnership by which a credit was extended upon the faith of the partnership. The practical impossibility of the partners knowing, by any feasible system of bookkeeping, all the persons with whom they have had dealings, unless credit has been extended, supports the wording by the Commissioners.⁹

Another uncertainty which would be ended by the Act is whether a partner, after all the debts of the partnership have been paid, is entitled to have the rest of the property sold in order to obtain his share in cash, or whether he has merely the right to a physical partition of the remaining partnership property. Section 38 provides that, unless otherwise agreed, each partner has a right to have his share of the surplus paid to him in cash.

Section 40 distinctly states that among the assets of a partnership are "The contributions of the partners necessary for the payment of all the liabilities." The adoption of this clause will end the present confusion as to whether the contributions of the partners towards the losses of the partnership are partnership assets or not, a confusion which in the Bankruptcy Act has rendered it possible in some districts to put a partnership containing a solvent partner into bankruptcy.¹⁰

There remain, as previously pointed out, two important questions in our present law of partnership on which there exists an almost hopeless confusion both in theory and practice, making the actual administration of the law difficult, and often, inequitable. One of these questions concerns the rights of the partner and the separate creditors of a partner in partnership property;

⁹ In further support of the provision as written, see 2 Bates, §§ 613, 614; Burdick, 57; Mechem, § 262; Beale's Parsons, § 319; Cal. Civ. Code, § 2453; 30 Cyc. 671. There is also authority for merely requiring that such "third person" shall have had dealings with the partnership. Bates, 612, 613; Collyer, 163; 3 Kent Comm. 67; Lindley, 249; Mechem, 261, 262; James Parsons, §§ 179, 180, 181; Pollock, 98; Shumaker, § 121.

¹⁰ See *In re Bertenshaw*, 157 Fed. 363 (1907); *Contra In re Forbes*, 128 Fed. 137 (1904). See also *Vaccaro v. Bank*, 103 Fed. 436 (1900); *In re Mercur*, 122 Fed. 384 (1903); *Barry v. Foyles*, 1 Pet. U. S. 311 (1828); *West v. Lea*, 174 U. S. 590 (1899).

the other, the rights of different classes of creditors where a business has been continued without liquidation by successive partnerships containing one or more common members. To understand the Act it is necessary to see clearly the way in which it deals with these two important subjects. To do this it is necessary to understand the confusions and difficulties of existing law. First we will have to see what are the rights of a partner and the separate creditors of a partner in partnership property.

As long ago as 1693 the rights of a judgment creditor of one partner came before Lord Holt in the case of *Heydon v. Heydon*.¹¹ Coleman and Heydon were partners. A judgment was had against Coleman, and all the partnership goods were taken in execution. Lord Holt held that the sheriff must seize all the goods and sell the undivided moiety thereof. He also declared that the property should be delivered to the purchaser, and that then the purchaser and the partner, Heydon, would hold the property as tenants in common.

Three propositions lie at the foundation of this decision: First: Partners are co-owners of partnership property; Second: They are joint tenants; Third: The purchaser of the partner's interest is a co-owner with the other partners of the partnership property; but the form of co-ownership, instead of being joint tenancy, is that known as tenancy in common. That Lord Holt should have come to the first conclusion was inevitable, as it is in exact accordance with the fact and with the understanding of partners. That he should have come to the second conclusion, namely, that the partners hold partnership property as joint tenants, while most unfortunate, was almost inevitable.

Ownership does not necessarily always involve the same legal incidents. Owners have different rights. The life tenant or holder and the tenant or holder in fee both own property, but their respective ownerships have attached to them different legal incidents. In the same way there are different legal incidents to different kinds of co-ownership. At the time of this decision, three kinds of co-ownership were definitely recognized—coparcenary, tenancy in common, and joint tenancy. When, therefore, the courts recognized partners as co-owners of partnership property, the next question was: In which one of these three ways do they hold? Joint tenancy had the legal incident known as

¹¹ 1 Salkeld 392.

survivorship; that is to say, on the death of one of the co-owners, his share, instead of passing to his heir, passed to the surviving owner or owners. This incident, which was peculiar to joint tenancy, fitted into a very practical necessity of partnership. If, on the death of a partner, his right in partnership property passed to his heirs, they would have a right to interfere in the winding up of the business. In the seventeenth century, as today, it was the understanding of partners that the survivor, in case of the death of one of them, should have the right to wind up the partnership affairs. The rule is fundamental that neither for the purpose of carrying on nor for the purpose of winding up the partnership does the heir of my partner become, on my partner's death, my partner.

Having, probably for the reason indicated, determined that partners held partnership property as joint tenants, all the other legal incidents of a joint tenancy were given to the co-ownership. Whatever may have been the origin of joint tenancy, it is certain that it did not grow up as a result of the partnership relation. It is, therefore, not to be wondered at that the application of the legal incidents of joint tenancy to partnership property at once produced, as it is still producing, inconvenience and inequities. The celebrated case of *Heydon v. Heydon* is one of the most prominent examples. Every step which Lord Holt indicated as proper in the case was consistent with the legal incidents of joint tenancy, and every step violates some fundamentally important principle of the partnership relation. For instance, the sheriff is allowed to seize partnership property. He does this at the instance of a judgment creditor of one of the partners. It is fundamental that a partner cannot use partnership property for his own benefit. He should use it for partnership purposes only. And yet, though the partner could not have used the partnership property to pay his separate debts, his separate creditor, securing a judgment against him, is permitted to seize partnership property for that purpose. Again, it is fundamental to the successful conduct of a partnership that the partnership property shall not be taken by strangers. Yet in *Heydon v. Heydon* the court allowed the purchaser of what is called the partner's moiety to take into his possession partnership property, and this in spite of the fact that the purchaser could not put it to any beneficial use. The purchaser did not become a partner. He could, however, insist upon a division of the property, and could insist on this division in the face of partnership articles which declared that

the partnership should not be dissolved or the property divided until the expiration of a specified term, which had not expired. Here, again, the decision of Lord Holt gave to the purchaser of the partner's moiety a greater right than the partner himself possessed.

In Iowa, to avoid the consequences of this decision, a debtor partner or his solvent associates are allowed to maintain a suit in a court of equity, to which all the partners and the creditor are parties, for a partnership accounting, the appointment of a receiver and an injunction restraining the sheriff from selling the debtor's uncertain interest in the property.¹² In other jurisdictions, as in Pennsylvania before the adoption of the Act, acts had been passed which permitted the purchaser to bring a bill in equity against the partnership for the purpose of ascertaining the partner's interest in the property purchased.

The fundamental defect of all these attempts to avoid the consequences of regarding partners as joint tenants of partnership property is the assumption that it is possible to ascertain the value of a partner's right in a specific piece of partnership property. Now it is fundamental to our partnership law that a partner has no beneficial interest in any specific piece of partnership property. The contract of partnership involves a mutual pledge by all the partners that the common fund shall be devoted first to the payment of partnership debts. After the debts are paid, if any property remains, it is to be devoted to the payment of the credits standing to the accounts of each partner on the books of the firm. In view of these rules, it is impossible to ascertain, except by purely arbitrary and artificial rules, a partner's beneficial interest in a specific chattel belonging to the partnership. A single illustration will make this clear: A and B are partners. The value of the partnership property is \$100,000; the liabilities amount to \$50,000. A has contributed \$15,000 and has a three-fourth's interest in the profits. A separate judgment creditor of A levies on A's interest in specific chattels belonging to the partnership, the value of these chattels being, let us suppose, \$5000. The chattels themselves must, under the partnership agreement, be still used for partnership purposes, and on dissolution, if still part of the partnership property, they must be sold. If the sheriff has levied on anything, it was not on a right in these chattels, but

¹² See *Aultman v. Fuller*, 53 Iowa, 60 (1880); Iowa Civil Code, §§ 3977 and 3978.

on a fractional part of A's interest in the partnership. But how is it to be determined what fractional part of A's interest in the partnership has been levied upon? Does the judgment creditor secure a lien to the value of \$5000 upon A's interest, or has he a lien for three-fourths of \$5000 on A's interest, or has he a lien on A's interest in the partnership which in amount bears the same proportion to the total value of the chattels, \$5000, as the amount which A would receive should the partnership be liquidated, bears to the total value of the partnership property at the time of the levy? It is impossible to answer these questions. Indeed, it is almost impossible to analyze them. A partner's interest in the partnership is his share of the profits and surplus. This can be ascertained on an account between the partners. But his fractional interest in a specific piece of partnership property it is not possible to ascertain.

Faced with the practical impossibility of ascertaining what the interest of a partner is in the specific property levied on, the courts have treated bills in equity brought by purchasers to ascertain that interest, as bills to ascertain his interest in the partnership, something that has not been levied on at all. Where this procedure is carried out we have the sheriff levying on a partner's interest in specific partnership property; the sale of that interest, and then a bill by the purchaser to obtain the partner's interest in the partnership. The practical defect of this procedure is that it requires the sheriff to sell the interest of the partner before the value of that interest is ascertained. A sheriff's sale, where the value of the thing sold is uncertain, usually means that the only purchaser is the creditor, or perhaps, a solvent partner. Outsiders do not wish to buy at sheriff sale something which may be worth nothing.

The proposed Act deals with the subject in a radically different way. Part V of the Act relates to the property rights of a partner. Section 24 declares that a partner's property rights are: (1) His rights in specific partnership property; (2) His interest in the partnership; (3) His right to participate in the management. Section 25 deals with the nature of a partner's rights in specific partnership property. It asserts that a partner is a co-owner with his partners of specific partnership property, holding, not as joint tenants, but "as tenants in partnership." The rest of the Section is devoted to definite statements of the different legal incidents of this tenancy.

These incidents are in the Act made to accord with the practical necessities of the partnership relation. Thus it is declared that while any partner has an equal right with his partners to possess partnership property for partnership purposes, he has not a right to possess such property for any other purpose, without the consent of his partners. It is also declared that a partner's right in specific partnership property is not assignable, except in connection with the assignment of the rights of all the partners in the same property. In other words, a partner may assign partnership property for a partnership purpose, but if he attempts to assign the property for his own purposes he makes no assignment at all, because the Act destroys the quality of assignability for any but a partnership purpose. If a partner cannot assign partnership property for his own purpose, it follows that his separate judgment creditor has no right to levy on such property.

Section 26 deals with the second property right of a partner—his interest in the partnership. This interest is defined as his share of the profits and surplus. He may assign his interest to others, and it is also made subject to the payment of any judgments secured by a separate creditor. Thus Section 28 provides that the court which entered the judgment, or any other court, on application of a judgment creditor, may charge the interest of a partner with the payment of the unsatisfied amount of the judgment; the court appointing a receiver for his share of the profits, and making all other orders, directions and inquiries which the debtor partner might have made or which the circumstances of the case may require.

After the adoption of the Act, when a judgment is secured against a partner by his separate creditor, all that the creditor will have to do is to apply to the court which gave him the judgment, or any other court, to issue an order on the other partners to pay him the profits which would be otherwise paid to his debtor, or to make any further order which will result in his securing the payment of his judgment without unduly interfering with the rights of the remaining partners in partnership property.

The other branch of the law of partnership in which at present serious confusion and inequities occur is that which relates to the rights of creditors when a business is carried on without liquidation by several successive partnerships having one or more members in common. These difficulties and inequities will perhaps be best shown by a specific illustration.

A, B and C are partners. E *et al.*, are their creditors. Without any notice to E *et al.*, or any settlement with them, D is admitted as a partner in the business. At the common law, as under the proposed Act, the admission of D dissolves the first partnership and creates a second partnership, composed of A, B, C and D. The property which belonged to the first partnership is now assumed by the law to belong to the second partnership. The second partnership contracts debts to other creditors, though in many instances these creditors may not know of the existence of D or that a new partnership has been formed. If now A, B, C and D, individually and as partners, become bankrupt, under the existing law, E *et al.*, the creditors of the first partnership, are not creditors of the second partnership. The partnership property, however, is the property of the second partnership, the practical result being that F *et al.*, the creditors of the second partnership, have a right to all property in the business until they are paid in full, before E *et al.*, who became creditors prior to D's admission to the business, get anything.

A similar clap-trap and inequitable result often takes place when a partner retires and the business is continued by the remaining partners, or by the remaining partners and other persons, without the liquidation of the affairs of the partnership of which the retiring partner was a member. Thus, if A, B and C are partners and A assigns to B and C his interest in the partnership, B and C continuing the business without any agreement to pay the partnership debts, under the present law, the property of the first partnership becomes the property of the second partnership, that composed of B and C, but the creditors of the first partnership are not regarded as creditors of the second partnership, though they are the creditors of the members of that partnership. The creditors of the first partnership are, therefore, often unable to secure satisfaction of their claims, because the property in the business must first be devoted to the payment of those creditors who extended their credit after the retirement of A, and this result is reached, though at the time of A's assignment to B and C the partnership may have been solvent, and the business may have been continued by the second partnership without any notification to the creditors of the first partnership of A's retirement from the business. This inequitable result the courts have attempted, in not a few instances, to prevent by declaring that the assignment of the property of the

first partnership to the second partnership was a fraud on the creditors of the first partnership, though no fraud was intended.

It will be noted that by transferring all the property in the business to the first partnership, those who extended credit to the second partnership cannot obtain any part of this property until the creditors of the first partnership are paid in full. It therefore results that the creditors of the second partnership are placed by the court in as hard a position as that from which the creditors of the first partnership have been relieved by the court's action.

The courts have also applied liberally the rule expressed in *Collyer on Partnerships*, that incoming partners may assume the debts of the concern with which they connect themselves; and this assumption may, both at law and in equity, be proved either by their express covenant or contract, or be inferred from the terms of it, or from the treatment of such debts by the firm, to the knowledge of the incoming partners, as the debts of the new firm.

The proposed Act does away with the uncertainties and inequities just described by two changes in existing law. One change is that embodied in Section 41. This Section provides that when a business is conducted by a partnership and a partial change in the personnel of the owners of the business takes place without liquidation of the affairs of the dissolved partnership, by the admission of a partner or the retirement or death of a partner and the assignment of his interest to those continuing the business, the creditors of the dissolved partnership become the creditors of the partnership continuing the business. In short, this Section recognizes the fact that the business has been one business from the start, and that those who have extended credit to the different partnerships conducting it should all, on the failure of the business, have equal rights in the property devoted to the business.

The other change in the law necessary to carry out the principle just explained is that embodied in Section 1. This Section makes a person who is admitted into a going business as a partner liable for all the debts of the partnership into which he is admitted contracted before his admission, except that his liability for these prior debts is confined to his interest in the partnership property. Thus, suppose A and B are partners. The partnership is indebted to E *et al.* C is admitted into the business and a new partnership of A, B and C is formed. The debts to E *et al.*, are not liquidated. C contributes \$5000 to the business.

Under the Act, C would be liable to E *et al.*, but his liability would be limited to his interest in the firm. He would only be liable in respect to his separate estate to those creditors who extended credit after his admission.

Though this Section changes the formal statement of the law, which is to the effect that an incoming partner is not liable for debts contracted before his admission, as a matter of fact, the Section, as worded, does not go as far towards making the incoming partner liable as most of the actual decisions of our courts. For where the courts hold, in the cases referred to, that the new partnership formed as a result of the admission of the partner has assumed the debts of the old partnership, they make the new partner liable for these debts, not only to the extent of his contribution to the business, but unlimitedly.

Two other, though minor changes in the law, remain to be mentioned. Section 26 provides that a partner's interest in the partnership—that is, his share in the profits and surplus—is personal property. This provision reverses the rule as established by the Massachusetts case of *Shearer v. Shearer*,¹³ which has been followed in most American jurisdictions. Experience has shown that the English courts in regarding the interest of the partner in the partnership as personal property, irrespective of the physical character of the property of the partnership, proceeded along sound, and therefore, practical lines.¹⁴ Partnership property is subject to the payment of partnership debts. Partners in winding up partnership affairs have a right to realize on partnership real estate before they sell the personal property of the partnership, if they consider such prior sale of the real estate an advantage to the firm. The fundamental trouble with the doctrine of *Shearer v. Shearer* is, that if the partnership agreement provides for the continuation of the business after the death of one of the partners, it is not possible to ascertain whether the real estate will or will not be sold for the payment of debts or to supply money for the carrying on of the business. Therefore, it may be impossible to determine whether the heir of the deceased partner inherits a fraction of the partner's interest in the partnership until several years after the death of his ancestor, and the ultimate determination depends, not on any principle of law or justice, but on the whim of the surviving partners. The

¹³ 98 Mass. 107 (1867).

¹⁴ *Darby v. Darby*, 3 Drewry 495 (1856).

provision of the Act which treats the interest of the deceased partner as personal property, makes for practical convenience as well as being in accord with the Section, heretofore referred to, which provides that every partner, on winding up, has a right to receive in cash the value of his interest in the firm.

The only other change in general law is in the Section relating to the right of a partner to contribution from co-partners for losses on contracts, entered into after dissolution. This Section provides that when dissolution is by death or bankruptcy of a partner, a partner thereafter acting for the partnership who had no knowledge or notice of the death or bankruptcy, may ask his co-partners to contribute their share of the liability created. Under existing law, where one partner dies, a partner who thereafter makes a contract for the carrying on of the business, though he makes the contract without knowledge and also without notice of the death, must assume the entire liability. He cannot ask his other partners to contribute towards his loss, if any, on the contract, even though they were ignorant of the death of the partner, and also even though such deceased partner was entirely inactive and may have resided at any distance from the actual place of business. The Commissioners believed that this was unjust to the acting partner or partners. The rule of the common law has been modified as to agency,¹⁵ and it is submitted that the Commissioners are right in believing that our partnership law, which here is but a branch of the law agency, should follow the present agency rule. What has been said of the death of a partner applies also to the bankruptcy of a partner. If there are a number of partners, and one of them becomes bankrupt, and another partner having no knowledge or notice of this fact, makes a contract in the ordinary course of business, there appears no reason why he should not be able to call on his other partners, not bankrupt or deceased, to contribute towards any loss which his separate estate may sustain on account of the contract.

At the outset it was noted that the Partnership Act had been in course of preparation by the Commissioners and their Com-

¹⁵ *Cassidy v. M'Kenzie*, 4 W. & S. 282 (Pa. 1842); Cal. Civ. Code, § 2356; N. Dak. Civ. Code, §§ 1150, 1151; Saunder's Rev. Civ. Code of La. (1909), § 3032; Md. Rev. Code (1878), 388, Art. 44, § 31; S. C. Gen. Stat. (1882), § 1302; English Conveyancing Act (1881), § 47; English Bankruptcy Act (1883), § 38; Kent. Comm. 646; Lindley, 240, *et seq.*; Mechem on Agency, § 245; Blackwood Wright (2d Ed. Eng.) on Principal and Agent, 332, *et seq.*; Story on Agency (1882), 598.

mittee on Commercial Law for more than twelve years. This was partly due to the fact that when the Committee on Commercial Law first undertook to draft a Partnership Act they and the draftsman selected, Dean Ames, were confronted with a difficulty from which most legal subjects are happily free. There exists—we may almost say existed—two theories of the legal nature of a partnership. One of these regards a partnership as an association of two or more persons carrying on business as co-principals. The name “aggregate,” which is sometimes given to this theory, does not very happily express the underlying idea that in partnership transactions the individual partners deal directly with each other and with third persons. This theory is also called the common law theory of partnership, because in the great majority of decisions relative to partnership transactions, consciously or unconsciously, the courts proceed on the underlying assumption referred to.

The other theory is, that when two or more persons form a partnership, the law should regard the association as having a legal personality distinct from the individual legal personalities of each partner. Under this theory, all partnership rights are vested in this legal personality of the partnership; on it are imposed all partnership obligations. The partners are the agents of the legal entity. The theory is called the entity theory—again not a very happy designation, as the essence of the theory is not that it regards the partnership or association as a distinct thing, but rather that it endows the association with a separate legal personality. By its advocates it has also been called the “mercantile theory,” on the assumption that business men in partnership transactions, whether *inter se* or with third persons, proceed on the fundamental premise on which the theory is based. Such an assumption, however, is entirely unwarranted. Business men, as such, have to do with fact, not legal theory. When a business man deals with persons carrying on business in partnership, the character of the partners and their total wealth, individual and collective, is all that is important to him. The rule that partners are unlimitedly liable for partnership debts is the only thing approaching a legal theory which he need carry in his mind.

In 1902, when the Committee on Commercial Law began to prepare the first draft of the Act, the second or entity theory, though its advocates admitted it changed our entire law of partnership, had gained a large number of adherents, among others, Dean Ames.

Mr. Ames believed that it would be impossible to solve many of the existing confusions and inequities in the law of partnership, especially the rights of the separate creditors of a partner, without adopting the entity theory. The two drafts which he prepared were both drawn on that theory.

That the entity theory does enable a satisfactory solution of the rights of separate creditors of the partnership to be had is evident. If the partnership is a legal entity against which the partners have claims for their shares in the profits and in the surplus, after the payments of debts to third persons, then the separate creditor of a partner may garnishee the fictitious legal person or bring a bill in equity against it for the purpose of ascertaining the claims of his debtor, and having these claims paid over to him, in the satisfaction of his judgment.

When the writer was selected to continue the work of Mr. Ames, it was not long before the difficulties created by the entity theory in other branches of the law of partnership began to appear, and I began to doubt the possibility of drafting a satisfactory act on this theory. It appeared to me that the proper way to settle the controversy was to present to the Committee on Commercial Law two drafts, one drawn on the entity and the other on the common law theory of partnership, and ask the Committee, before submitting the drafts to the Commissioners, to call a meeting of persons having special knowledge of the law of partnership to discuss the drafts and the respective theories underlying them. This idea was carried out. Two drafts were drawn, and the conference suggested held in Philadelphia in the fall of 1910. Practically all teachers and writers on the law of partnership in the United States were present, as also a number of lawyers known to have made a special study of the subject. At the conclusion of the discussion, the members of the conference all joined in recommending that the Act be drawn on the common law or aggregate theory, and that the partners be treated as owners of partnership property holding by a special tenancy, which should be called tenancy in partnership. This recommendation, as explained, has been carried out.

One of the chief difficulties with the entity theory is that, while it enables us to solve the rights of the separate judgment creditor of a partner in the partnership property, it makes it impossible to work out in a satisfactory way the rights of a firm creditor against the separate property of a partner. If the partnership is a separate legal personality, what is the relation of the partners

to those who have business transactions with the partnership? Are they to be regarded as co-principals and the partnership contract with third persons as a joint contract of the partners and the legal entity; or shall the partners be regarded as guarantors or as sureties; or shall the partners be regarded as not having any legal relation to those who deal with the partnership, but merely contracting with the legal entity to pay partnership debts, if the property of the entity is not sufficient to pay them?

This last position, which denies all contractual relations between the partners and the person dealing with the partnership, was the one taken by Mr. Ames. Indeed, consideration seemed to indicate that it was the only position that gave any promise of a satisfactory solution of the many problems raised. If the partners have no contract with those who deal with the partnership, it follows that a firm creditor who secures a judgment cannot levy that judgment on the separate property of a partner. He must, to be consistent with the theory, be required after judgment to bring a new proceeding against the partner whose separate property he desires to subject to the payment of his debt. This is a cumbersome proceeding. It is based on a theory which violates the idea of every business man who deals with a partnership, that he is dealing with a group of persons who are directly and unlimitedly liable for partnership obligations.

Should we abandon Mr. Ames' position, and while adopting the entity theory, regard the partners as co-principals or guarantors of the entity, while some of our difficulties disappear, the pertinent inquiry may be made: Why create a fictitious legal person when in every suit you have to join the partners as co-principals? Are you not merely adding to an already complicated situation, a fictitious person, which has to be constantly considered in all proceedings by or against the partnership?

The most serious practical difficulty, however, in the way of the entity theory is, that, as Mr. Ames admitted, it necessitates the creation of a system for the registration of all partnerships, and a provision that no partnership can exist until it is registered. Any system which prevents a partnership from being in existence until it is registered, and which thus introduces into the law of partnership the difficulties which surround *de facto* corporations, should not be tolerated for a moment unless the necessity for the adoption of the theory is imperative. No such necessity exists.

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